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Date 8/23/99

Surname [REDACTED] # [REDACTED]  
[REDACTED] DOO [REDACTED]

OP:E:EO:T:4

JUN 12 1999

Ladies and Gentlemen:

We have considered your application for recognition of exemption from federal income tax under section 501(c)(3) of the Internal Revenue Code.

Your stated purpose is to provide scholarships to the dependent children of employees of [REDACTED]. Your founder, [REDACTED], is considered an employee of the company. The scholarships will be a variable, special purpose award to cover tuition, fees, books and dormitory room and board.

You have represented that [REDACTED] will select and award the scholarships each year and his decision as to which candidates receive the scholarships and the amount and schedule of payments will be final.

You have further represented that, in the near term, two or three applications are expected and that [REDACTED] will fund the scholarships.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(a)-1(c) of the Income Tax Regulations states, in part, that the words private shareholder or individual refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(a) of the regulations states, in part, that if an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for

charitable or educational purposes unless it serves a public rather than a private interest. Thus, to meet this requirement, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders or the organization, persons controlled directly or indirectly, by such private interests.

Rev. Proc. 76-47, 1976-2 C.B. 670 provides guidelines to be used in determining whether a grant made by a private foundation under an employer-related grant program to an employee or to a child of an employee of the particular employer to which the program relates is a scholarship or fellowship grant subject to the provisions of section 117(a) of the Code. The ruling further provides that if a private foundation's program does not satisfy one or more of the seven conditions set forth in sections 4.01 through 4.07, the Service will not issue a ruling that the grants awarded are scholarships or fellowship grants under 117 of the Code.

Rev. Proc. 76-47, provides that when educational grants are made available by an employer to its employees on a preferential basis, the employer-employee relationship is immediately suggestive that the grant is compensatory. Such preferential grants by an employer to the children of his employees suggests a purpose to compensate or otherwise provide an employment incentive to the employee-parents. The ruling further states that the Service will not treat a foundation's employer-related grant program as designed or administered for such a purpose if the availability of a grant to an employee or his child falls outside the pattern of employment. In order to be outside the pattern of employment, the availability of a grant to an employee or his child under the program must be controlled or limited by substantial non-employment related factors to such an extent that the preferential treatment derived from employment does not, of itself, confer any significant probability that employment will make a grant available for an otherwise qualified employee or his child interested in applying for one.

Section 4.02 of Rev. Proc. 76-47, provides that selection of grant recipients must be made by a committee consisting wholly of individuals totally independent (except for participation on this committee) and separate from the private foundation, its organizer, and the employer concerned.

Section 4.08 of Rev. Proc. 76-47, provides in the case of a program that awards grants to children of employees of a particular employer, the program meets the percentage test if the

number of grants awarded under that program in any given year to such children does not exceed 25 percent of the number employees' children who, (i) were eligible, (ii) were applicants for such grants, and (iii) were considered by the selection committee in selecting the recipients of grants in that year, or 10 percent of the number of employees' children who can be shown to be eligible for grants (whether or not they submitted an application) in the year. Additionally, in order to meet the 10% test an employer would need to agree to conduct a survey, for any year in which scholarships are awarded, showing 10 eligibles for every individual receiving a scholarship.

The information submitted demonstrates that your scholarship program is organized and operated to serve private interests rather than serve public interests, as proscribed in section 1.501(c)(3)-1(d)(1)(ii) of the regulations.

The scholarship program would provide private benefit to the employees of [REDACTED] in that the scholarships are restricted to the children of these individuals. Given the restricted, preferential nature of the scholarships, we have reached the conclusion that these scholarships amount to a form of extra compensation to employees. The standards set in sections 4.02 and 4.08 of Rev. Proc. 76-47 have not been met. Such preferential grants by an employer to the children of his employees suggests a purpose to compensate or otherwise provide an employment incentive to the employee-parents. The employer-related preferential treatment does not, of itself, further in any way the requisite disinterested purpose of simply making it financially possible for individuals to obtain an education for their own personal benefit, and suggests the presence of a contrary purpose to provide extra compensation, an employment incentive, or an employee fringe benefit.

The scholarship program also serves the private interest of [REDACTED] because [REDACTED] has sole control over the selection and award of scholarships to the recipients.

Thus, it is our conclusion that your scholarship program is organized and operated to provide private benefit to [REDACTED] and his employees rather than to serve the public interest. Therefore, as provided in section 1.501(c)(3)-1(a) of the regulations, we find that you are neither organized or operated exclusively for one or more purposes as specified in section 501(c)(3) of the Code and, you are not entitled to be recognized as exempt from federal income tax under section 501(c)(3).

[REDACTED]

You have a right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted in duplicate within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by some one who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements.

If you do not protest this proposed ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to the District Director, Cincinnati, Ohio. Thereafter, any questions about your federal income tax status, or the filing of tax returns should be addressed to that office. Also, the appropriate state officials will be notified of this action in accordance with section 6104(c) of the Code.

Sincerely yours,

(Signature)

Gerald V. Sack  
Chief, Exempt Organizations  
Technical Branch 4

CC: [REDACTED]  
[REDACTED]  
[REDACTED]

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Sack by  
[REDACTED]  
[REDACTED]